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Rationality in Rate-Making

L. A. S.

West Virginia University College of Law

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RATIONALITY IN RATE-MAKING.—Mr. Justice Holmes' observation that "general propositions do not decide concrete cases"¹ is illustrated adequately by the maelstrom of decisions and comments on public utility regulation by rate-making. The legalist's search for the panacea of a catch-all major premise has resulted often in a sugar-coated placebo that has no actual effect on concrete cases. The wandering day-by-day factual holdings of the courts are strongly indicative that the rate-making process is not susceptible to a singular approach or even to a binary one. The *Hope*² case and the *Natural Gas Pipeline Co.*³ cases are the Court's admission of this, and they are in harmony with the neo-legal philosophy that, "The trend of modern decisions is to administer justice in accordance with the realities disclosed by the facts; no legal fiction, however revered in antiquity, should be given effect when it is clearly antagonistic to the facts, to common sense, and to natural justice."⁴ This article submits that the two cases are not enigmatic decisions but are ones that lay a basis for a rate-making process that will yield results asymptotic to that abstract principle of justice.

From the common law property concept that "when private property is devoted to public use, it is subject to public regulation"⁵ has descended the *rationale* for public utility law. One accepted manner of regulation has been by price-fixing, which necessitates the incorporation into that law of the general principles of constitutional law prohibiting deprivation of property without due process of law or taking private property for public use without just compensation.⁶ Originally, price-fixing of the commodity or service of a business classified as a public utility was accomplished through the imposition of the affirmative common law duty that the prices charged had to be "reasonable"; violation of this duty allowed the injured party a recovery back of the overcharge.⁷ The retroactiveness, inequality, and inadequacy of this judicial process of control caused the intervention of the legislators to accomplish the price fixing either by direct action or by delegation of their powers and

¹ *Lochner v. New York*, 198 U.S. 45, 76 (1905).

² *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

³ *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575 (1942).

⁴ *Wirt Franklin Petroleum Corp. v. Guen*, 139 F.2d 659 (5th Cir. 1944).

⁵ *Munn v. Illinois*, 94 U.S. 113 (1877).

⁶ *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38 (1936).

⁷ *W. Va. Transportation Co. v. Sweetzer*, 25 W. Va. 434 (1885).

functions because of the complexities involved⁸ to administrative tribunals, with the general standard that the prices fixed be "just and reasonable."⁹ Thus, instead of a retroactive determination of reasonableness, *in futuro* decisions were made in the hope of achieving stability and uniformity. The traditional method used to arrive at a fixed price or rate was to adjust the price or rate so that a reasonable and fair return could be made by the utility on its predicted property value to be devoted to the public use.¹⁰ This required determination of the value of the property so used, *i.e.*, a "rate base", and a "rate of return" to be allowed on that base.¹¹ The defining of this rate base and its component parts resulted in continual disagreement.¹²

This process of control is the focus of several legal problems and is the causation of differing views concerning the solution of a concrete case depending on the acceptance or resolution of basic theories or philosophies. The following questions, which are some of the usual ingredients of a rate-making decision, exemplify this:

1. Is it necessary to find a rate-base with its superimposed rate of return in order to arrive at a reasonable rate?¹³
2. If a rate-base approach is used, should any one formula be required; *i.e.*, what concept of value should apply?¹⁴
3. What is a proper relation between the doctrines of administrative finality and of the supremacy of the law?¹⁵
4. Are the only interests to be respected and protected those of the investors and the consumers?¹⁶

⁸ "There was a time in the history of this country when carriers and public-service corporations were so few that the legislature itself might have performed the labor; but, by reason of the rapid growth of population and the great increase in the number of such corporations, it has become impracticable for the legislature to discharge that duty. Moreover, many rates may require alterations from time to time." *Trustees of Saratoga Springs v. Saratoga Gas, Electric Light & Power Co.*, 191 N.Y. 123, 83 N.E. 693 (1908).

⁹ For example, see W. VA. REV. CODE c. 24, art. 3, § 1 (1931), providing that "All charges, tolls, and rates shall be just and reasonable."

¹⁰ *Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276 (1923).

¹¹ *Wilcox v. Consolidated Gas. Co.*, 212 U.S. 19 (1909); 2 *BONBRIGHT, VALUATION OF PROPERTY* c. 30 (1937).

¹² Hardman, *Present Value Doctrine and Present Investment Doctrine*, 30 W. VA. L.Q. 70 (1924).

¹³ Freeman, *Enlightened Judgment Approach to Rate of Return*, 61 HARV. L. REV. 1380 (1948).

¹⁴ Hale, *The "Fair Value" Merry-Go-Round, 1898 to 1938: A Forty-Year Journey from Rates-Based-on-Value to Value-Based-on-Rates*, 33 ILL. L. REV. 517 (1939).

¹⁵ *Compare Arizona Grocery Co. v. Atchison, T. & S.F. Ry.* 284 U.S. 370 (1932), with *United Railways & Elec. Co. of Baltimore v. West*, Chairman, 280 U.S. 234 (1930); Freund, *The Right to a Judicial Review in Rate Controversies*, 27 W. VA. L.Q. 207 (1921); Hardman, *Administrative Finality in Claims for Overcharges*, 51 W. VA. L.Q. 77 (1948).

¹⁶ See Justices Jackson's and Frankfurter's dissent in the *Hope* case.

Certainly the listing is incomplete, but the questions demonstrate that there are several fundamentals within the rate-making process that give footings upon which individual judges diverge. Usually fair argument can be given to support one or another answer to a question. With regard to question one, the rate-base-rate-of-return method has been customary,¹⁷ although the scope of the *Hope* case might now conceivably include other methods, such as the approach suggested by one writer that only the investor is entitled to a fair return as the utility itself is affected by the public interest and not just its property.¹⁸ The acceptance of the rule of *Smyth v. Ames*¹⁹ requiring that the fair or present value concept be used in finding a rate-base, answered question two for a time, although its principle was continually under attack.²⁰ Various answers have been supplied to question three, depending upon the exigencies of each case. The usual view is that because the rates fixed look to the future, the fixing of the rates is a legislative act,²¹ subject, however, to judicial review of some sort.²² In cases where a recovery back is sought because of an unreasonable rate, the function is viewed as administrative, divided into judicial and legislative components.²³ The answer to question four is usually assumed to be "yes",²⁴ but Mr. Justice Jackson's dissent in the *Hope* case is a signpost to a changing outlook of the courts.

The dissent of Justices Brandeis and Holmes in the *Southwestern Bell Telephone* case²⁵ strongly indicated that determination of a reasonable rate is largely founded upon formed judgments. These judgments, of course, must be deduced from a multi-

¹⁷ *Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276 (1923).

¹⁸ BAUER, *TRANSFORMING PUBLIC UTILITY REGULATION* 168 (1950).

¹⁹ 169 U.S. 466 (1898).

²⁰ The principle has been "widely rejected by the great weight of economic opinion, by authoritative legislative investigations, by utility commissions throughout the country, and by impressive judicial dissents." Mr. Justice Frankfurter's opinion in *Driscoll v. Edison Light & Power Co.*, 307 U.S. 109 (1939).

²¹ *San Diego Land & Town Co. v. Jasper*, 189 U.S. 439 (1903).

²² *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38 (1936) (only to check for substantial evidence in the record); *Minnesota Rate Cases*, 230 U.S. 352 (1913), *Chicago M. & St. P. Ry. v. Minnesota*, 134 U.S. 418 (1890) (an independent enquiry into the facts).

²³ *Arizona Grocery Co. v. Atchison, T. & S.F. Ry.*, 284 U.S. 370 (1932).

²⁴ "So long as the public interest—i.e., that of investor's and consumer's—is safeguarded, it seems that the Commission may formulate its own standards." *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 15 (D.C. Cir. 1950).

²⁵ 262 U.S. 276 (1923).

tude of preliminary facts,²⁶ and whether the deductive process be considered legislative, judicial, or administrative, is a matter of classification. Whatever the label, it must be performed by some person or group of persons. The *Hope* case is but a confession by the Court that the demands of society in this field of law can be served better by others who are as capable or more capable than the courts to form the necessary judgments.²⁷ Administrative agencies have continually proved their reliability and competency to contend with the regulatory problems that the complexities of society present today,²⁸ and the *Hope* case acknowledges this.

Mr. Justice Douglas declared in the *Hope* case that the commission was not bound to any one formula in determining a rate-base, that infirmities in the method used would be tolerated, and that only the end result on the commission's action would be judicially scrutinized. This removes any possibility of a negative attack on the rate orders, leaving only positive proofs to destroy them. That is, within the requirements of due process,²⁹ the failure of the commission to perform an act or to perform it in a certain manner is no longer suitable grounds for reversal;³⁰ positive showing that the end result is not just and reasonable is demanded.

If the Court has "conceded the commission the prerogative of ascertaining the rate-base",³¹ what function has the Court retained for itself in the rate-making process? Certainly it has retained the

²⁶ The standard of the *Hope* case is not "so vague and devoid of meaning as to render judicial review a perfunctory process. It is a standard of finance resting on stubborn facts." *Colorado Interstate Gas Co. v. Federal Power Comm'n*, 324 U.S. 581, 605 (1947). "Without any evidence on this essential issue, there is no basis for application of any standard and the judicial review authorized by the statute becomes a formal but futile gesture." *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 16 (D.C. Cir. 1950).

²⁷ "A major question presented for determination by the commission was the ascertainment of a proper rate base for Safe Harbor. This problem is really one of valuation and of accounting. The other major question for the commission was the determination of a 'fair return' on that rate base. Both questions are peculiarly within the administrative capacity of the Commission." *Safe Harbor Power Corp. v. F.P.C.*, 179 F.2d 179 (3d Cir. 1949); see also note 33 *infra*.

²⁸ LANDIS, *THE ADMINISTRATIVE PROCESS* (1938).

²⁹ "The Fifth Amendment in the field of federal activity, and the Fourteenth, as respects state action, do not prohibit governmental regulation for the public welfare. They merely condition the exertion of the admitted power, by securing that the end shall be accomplished by methods consistent with due process. And the guaranty of due process, as has been often held, demands only that the law shall not be unreasonable, arbitrary, or capricious, and that the means selected shall have a real and substantial relation to the object sought to be attained." *Nebbia v. People*, 291 U.S. 502 (1934).

³⁰ *Interstate Natural Gas Co. v. F.P.C.*, 156 F.2d 949 (5th Cir. 1949); *cf. Colorado-Wyoming v. Federal Power Comm'n*, 324 U.S. 626 (1945).

³¹ *Cf. The Hope Case and Recent Federal Decisions*, 54 W. VA. L. REV. 305, 307 (1952).

right to review, consistent with the due process clause and the doctrine of the supremacy of the law.³² The evaluation of the reasonableness of a rate, however, necessitates its comparison to a standard. Apparently the Court has chosen to set aside any *stare decisis* yardstick—reference to any one pre-stated standard is no longer requisite. What, then, is to be the guide when a rate is reviewed? The Court answered this by its placing of the burden of proof³³ which, in effect, invited the lawyers to formulate the necessary standard for measurement for each case. The lawyer is now freed from scratching among the ashes of past decisions for arguments that one general proposition, rather than another, *i.e.*, fair value *v.* prudent investment, is the true method always to be used to determine a rate-base, when neither may be particularly applicable or when some method other than the rate-base method is a better approach. He is now entitled to formulate a contemporary method, to prove the logic of its component parts, to show its rationality to the particular facts in dispute, and to do all this independent of the commission's method. If he succeeds in proving the fitness of his method and its actual answering of the particular questions, then he has established a reference point which the court will use to test the end result of the commission's order. The commission is entitled to justify the determined rate by any rational method, whether by using the rate-base-rate-of-return method, attraction of capital theory,³⁴ flexible rate of return theory,³⁵ value to the consumer method,³⁶ or others. The one seeking to upset it has a better chance for success not by showing the piece-meal inadequacy of the commission's method, but by a positive demonstration that another is more suitable. No longer is the attacker bound to have his case stand or fall on a standard or method formerly approved by the court, for the *Hope* decision removed all judicial approval of any particular standard or method formerly in vogue.

³² "... the reservation of full authority to the court to deal with matters of law provides for the appropriate exercise of the judicial function in this class of cases." *Crowell v. Benson*, 285 U.S. 22 (1932).

³³ "Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

³⁴ *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276 (1923), dissent.

³⁵ See note 13 *supra*.

³⁶ *Cotting v. Kansas City Stockyards Co.*, 183 U.S. 79 (1901).

The present position of the Court is not one of complete capitulation to administrative finality, which is only as final in any particular case as the court allows it to be in its role as final arbitrator, but it is simply recognition of administrative competence.³⁷

If the above states correctly the *rationale* of the *Hope* and the *Natural Gas Pipeline Co.* holdings, then the cases portend a series of decisions that will, with apparent disregard for consistency, accept, reject, or compromise all the former arguments of the rate-making cases. Whether fair value, prudent investment, present market value, historical costs, or other methods are used to calculate a rate-base, whether depreciation of certain items, good will, going concern value, or abandoned properties are included in the rate-base, or whether the rate-base is used at all—each will be accepted or rejected in a particular case. This may lead to inconsistency or confusion in the eyes of those seeking formalism and generalities, but this process of judicial “inclusion and exclusion” is the only proper way to define the relativity between society’s and the individual’s interest in a problem which has such a vast number of factorials as does public utility regulation.

It is submitted, then, that the *Hope* and the *Natural Gas Pipeline Co.* cases were a deliberate clearing away of the debris of former decisions so that there could be the desirable fluidity and flexibility in the rate-making process, and that this enlightened approach to a practical problem will continue—at least so long as the liberal element reigns in the Supreme Court of the United States.

L. A. S.

THE RIGHT OF PETITION.—In the parade of decisions on the Constitution and its principles, the right to petition¹ has been and still is accorded little opportunity to participate in all the legal pomp and ceremony accompanying the procession. Unlike freedom of speech, it is unusual for this constitutional guarantee to be considered separately from its cohorts. Greater contemplation is

³⁷ “. . . in a question of rate-making there is a strong presumption in favor of the conclusions reached by an experienced administrative body after a full hearing.” *Darnell v. Edwards*, 244 U.S. 564 (1917). “The limits set by the court are deliberately broad, resulting both from notions of special competence and the conception of rate-making as a primarily legislative process.” *Washington Gas Light Co. v. Baker*, 188 F.2d, 11, 15 (D.C. Cir. 1950).

¹ “Congress shall make no law . . . abridging . . . the right of the people . . . to petition the Government for a redress of grievances.” U.S. CONST. AMEND. I.